

**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**

<b>COMMONWEALTH EDISON COMPANY</b>	)	
	)	
	)	<b>Docket No. 13-0318</b>
<b>Annual formula rate update and revenue</b>	)	
<b>requirement reconciliation under</b>	)	
<b>Section 16-108.5 of the Public Utilities Act</b>	)	

**APPLICATION FOR REHEARING**  
**OF THE PEOPLE OF THE STATE OF ILLINOIS**

**The People of the State of Illinois**

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**APPLICATION FOR REHEARING**  
**OF THE PEOPLE OF THE STATE OF ILLINOIS**

The People of the State of Illinois, by and through Lisa Madigan, Attorney General of the State of Illinois (“the People” or “the AG”), pursuant to Section 10-113(a) of the Public Utilities Act (220 ILCS 5/10-113(a), and Part 220.880 of the Commission’s Rules of Practice (83 Ill. Admin. Code 200.880), request that the Commission grant rehearing on several issues in its Final Order (“Order”) issued in the above-captioned consolidated docket on June 18, 2013, and served on June 19, 2013.

**I. INTRODUCTION**

On December 18, 2013, the Commission entered its Final Order in this proceeding. In that Order, the Commission recommends adjustments that would reduce the Company’s proposed revenue requirement by approximately \$1.95 million. The additional adjustments presented in the People’s Briefs that were rejected by the Commission will reduce the amount borne by ratepayers by an additional \$8.41 million above and beyond the adjustments approved in the Final Order. First, the Commission’s conclusion on the People’s proposed adjustment to accumulated deferred income taxes (“ADIT”) on vacation pay fails to address the threshold issue

raised by the People: should capitalized vacation pay be included in rate base? The answer, as explained below, is no. Next, the Commission also rejects the People's well-supported adjustment to remove expenses related to Exelon stock price discounts and related income taxes associated with the ComEd Employee Stock Purchase Plan ("ESPP"). The Final Order further burdens ratepayers by failing to acknowledge that, by using the Company's own tax deduction information, the People have shown that ComEd's treatment of stock-based compensation programs is systematically one-sided to the disadvantage of ratepayers. Finally, the Commission should assign 100 percent of the Late Payment Charges to ComEd's jurisdictional delivery services revenue requirement, ceasing the Allocation to Transmission in the Company's proposed revenue requirement.

Additionally, ComEd's Revised Formula Rate Tariff approved by the Commission on June 5, 2013 in Docket No. 13-0386 included formula rate provisions that were overbroad and improperly changed provisions of the formula that P.A. 98-0015 did not address or authorize. Specifically, the Company's calculation of the ROE collar adjustment and grossing up of the WACC interest rate on the reconciliation under-recovery are not authorized by 98-0015 or by other EIMA provisions. In addition, the Company's failure to recognize the ADIT on the reconciliation under-recovery prior to application of the WACC interest is contrary to fundamental and well-established Article IX ratemaking principles. The proposals presented by the People to consider and change the structure and protocols of ComEd's formula rate tariff related to (1) the reflection of deferred income taxes on the reconciliation under- or over-recovery; (2) the appropriate method of calculating ComEd's weighted average cost of capital ("WACC") on the reconciliation over- or under-recovery and (3) the reflection of average rate base rather than year-end rate base in the return on equity collar calculation were determined by

the Commission to be “beyond the scope of this Section 16-108.5(d) annual update and reconciliation proceeding”, with the Commission noting that these issues were being addressed in Docket No. 13-0553. If permitted to remain in place, the unauthorized formula rate tariff changes approved in the Revised Formula Rate Tariff, as well as that tariff’s failure to determine the “net of tax” reconciliation balance, would unjustly enrich ComEd in the pending and future annual reconciliation proceedings under sections 16-108.5(d) of the Act.

The Commission rejected, in its November 26, 2013 Final Order in 13-0553<sup>1</sup> recommendations of the People and other Intervenor<sup>2</sup>s regarding two important components of the reconciliation calculation – one related to the recognition of accumulated deferred income taxes (“ADIT”) in the calculation of the reconciliation under- or over-recovery, and a second related to the calculation of the Company’s return on equity collar adjustment, pursuant to Section 16-108.5(d) of the Act. Without the modifications to the Revised Formula Rate Tariff recommended by the People both in this docket and in Docket No. 13-0553, ComEd will continue to collect revenues that do not reflect the Company’s actual costs, and if not corrected, will unfairly impact rates going forward through the year 2022, when the formula rate regulatory structure is set to expire. The result would be customer rates that are not just and reasonable under sections 9-101 and 16-108.5(c) of the PUA and inconsistent with the goals of EIMA to base rate on “actual costs.” The Final Order in this docket indicates that these issues were resolved in Docket No. 13-0553. The Commission, however, should revisit the conclusions reached in the Final Order in that docket to adopt the recommendations of by the People, and incorporate those rate changes in the final revenue requirement established in this docket, as

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<sup>1</sup> The related docket investigating the Company’s tariffs approved in 13-0386.

<sup>2</sup> Those Intervenor<sup>2</sup>s are the Illinois Industrial Energy Consumers, the City of Chicago and the Citizens Utility Board (“CCI”).

discussed in the People's Briefs on Exceptions filed on November 18, 2013 and in the People's Application for Rehearing in ICC Docket No. 13-0553.

These arguments are discussed further below.

## **II. The Final Order Misunderstands the People's Adjustment to Accumulated Deferred Income Taxes on Vacation Pay**

In reaching its decision in its Final Order, the Commission fails to address the threshold question raised by the People: *should the capitalized vacation pay be included in rate base?* As explained by the People, the answer, of course, is no because the Company's operating reserves represent accruals, including accrued vacation pay, that have yet to be disbursed as cash. AG Initial Brief (hereinafter cited as "IB") at 13; AG Reply Brief (hereinafter cited as "RB") at 8; AG Brief on Exceptions (hereinafter cited as "BOE") at 5; AG Ex. 4.0 at 4. These operating reserves are deducted from plant in service when determining rate base. AG IB at 13; AG RB at 7-8; AG BOE at 4-5; AG Ex. 4.0 at 4-5.

When calculating the expenses related to vacation pay, the Company charges a portion to expenses and charges another portion, which represents the amount to be added to plant accounts, to a deferred debit account. AG IB at 13-14; AG BOE at 5; AG Ex. 2.0 at 5; 4.0 at 4-5. This second portion, the deferred debit, is added by the Company to rate base because the costs have not been recovered from ratepayers. AG IB at 13; AG BOE at 4-5; AG Ex. 2.0 at 4; 4.0 at 4. It is this second portion that is critical to the People's analysis – and not fully acknowledged by the Commission in the Final Order – because the People demonstrated that the Company improperly records a portion of vacation pay to be capitalized to plant accounts as a deferred debit as a separate addition to its rate base. AG IB at 13-14; AG BOE at 5; AG Ex. 2.0 at 3-4; 4.0 at 4-5.

Undisputed evidence in the record and previously noted by the People in their Briefs is that the *capitalized* vacation pay does not represent actual investor-supplied funds. This is a critical piece to the puzzle that the Final Order does not address. See Order at 15. As AG witness Mr. Effron testified:

this item does not require investor supplied funds and should not be explicitly included in the Company's rate base. Rather, the associated debit balance should be netted against the accrued vacation pay that is included in operating reserves.

AG Ex. 2.0 at 5; AG IB at 14. It naturally follows, as described in great deal in the People's Briefs, that this portion of vacation pay should not be added to rate base to begin with. The Final Order, however, pays no attention to this important distinction and merely accepts the Company's position. Order at 15. It is important to note that the People are *not* proposing to recognize any "additional deferred tax liability" related to capitalized vacation pay – as the Final Order concludes. Order at 15. In its simplest form, the People are proposing that the ADIT be limited to the accrued vacation pay that should be taken into account in the determination of rate base.

The People, in their testimony and Briefs, broke down this adjustment to its essence and explained that when the capitalized vacation pay is excluded from rate base, as it should be, it is *irrelevant* whether there are any related deferred taxes or not. AG IB at 15-16; AG RB at 8-9; AG BOE at 5. The underlying calculations and the justification for these calculations were explained in greater detail in the People's Briefs and in Mr. Effron's testimony. See AG IB at 14-16; AG RB at 8-9; AG BOE at 4-5; AG Ex. 4.0 at 2-4. As noted by the People in their Reply Brief, simply because the investors supply the capital for a portion of this deferred debit (see

ComEd IB at 25) does not automatically mean that ratepayers should be on the hook for reimbursing the investors. AG RB at 8-9.

Finally, the Final Order concludes that, as it found in Docket 12-0321, the Company's calculation is correct. Order at 15. Although the Order in 12-0321 reached the same conclusion as the Final Order does here, this is a misstatement of the Order in 12-0321, which sought to explore this issue further. Docket No. 12-0321, Final Order (December 18, 2012) at 17. The People, for their part, have presented thorough and thoughtful discussion on this issue, in line with the Commission's directive in 12-0321. The Final Order, unfortunately, misses the point of the People's discussion and provides a series of perfunctory conclusions on the issue. Based on the above, the Commission's decision to reject the People's adjustment on ADIT related to Accrued Vacation Pay is contrary to law, not supported by substantial evidence, arbitrary and capricious and beyond the jurisdiction of the Commission, contrary to Section 10-201(e)(iv)(A-D) of the Act. In support of this point, the People incorporate by reference the arguments presented at pages 13-16 of the AG Initial Brief; pages 7-9 of the AG Reply Brief; and pages 4-6 of the AG Brief on Exceptions. Accordingly, the People request that the Commission grant rehearing on this matter.

### **III. The Final Order Disregards the People's Proposal on Employee Stock Purchase Plan**

The People presented a well-reasoned adjustment to remove expenses incurred for Exelon stock price discounts and related income taxes associated with the ComEd Employee Stock Purchase Plan ("ESPP"). AG IB at 23. In support of their position on the discount expenses, the People presented strong evidence that, like the disallowed expenses at issue in Docket No. 11-0721, the ESPP discount expenses should be disallowed because the Plan is a non-recoverable, stock-based compensation arrangement. AG IB at 24, 26, 27. As to the income



tax expenses, the People demonstrated that charging ratepayers for income taxes arising from changes in the value of Exelon stock within the ESPP is clearly inconsistent with the intent of section 108.5(c)(4)(A) of the Act. AG IB at 28; AG RB at 14. The Final Order, unfortunately, accepts the Company's position with little relevant analysis. Order at 56.

### **A. Stock Price Discounts**

The conclusions reached by the Commission related to the stock price discount issue are neither supported by record evidence or law. Specifically, the Final Order concludes that "ESPP is a fringe benefit and not an incentive based program based on job performance" primarily because it is not given as a reward and employees must purchase the stock with their own funds. Order at 56. The People, however, raised several important points refuting this conclusion. Notably, the People demonstrated that the Plan directly ties the value of employee benefits to the earnings and financial performance of Exelon, rather than achievement of the statutory criteria referenced by the Commission in its Order in Docket No. 11-0721. AG IB at 26; AG RB at 13-14; AG BOE at 7-8; AG Ex. 1.0 at 28. Briefly stated, the People presented evidence that the functioning of the ESPP increases ComEd's A&G expenses and impacts the delivery service revenue requirement in an amount associated with the fair value of the option on the purchased stock. AG IB at 25-26; AG RB at 13-14; AG BOE at 7-8; AG Ex. 3.0 at 29. At the same time, however, the plan provides a financial incentive for participants in the ESPP to maximize the earnings and financial performance of Exelon. See AG Ex. 3.1. The Final Order, however, ignores these important points, as well as the testimony of AG witness Mr. Brosch who testified that the *functioning* of the ESPP demonstrates that it is not simply a fringe benefit plan. AG IB at 25-26; AG RB at 14; AG BOE at 7-8; AG Ex. 3.0 at 29.

The Final Order also concludes that “ESPP is also not given as a reward because employees must purchase stock with their own funds.” Order at 56. This conclusion misses the point of the People’s argument completely. The People demonstrated that *ComEd* subsidizes the purchase of *Exelon* stock by offering a discounted share price, exposing ratepayers to significant expenses arising from the ESPP share price discount. AG IB at 26; AG BOE at 8. Therefore, it makes little difference that the employees use their own funds to purchase the stock at a discount. The point is that ComEd is subsidizing the cost of stock at ratepayers’ expense. The Final Order, however, ignores this important distinction, particularly where it concludes that “the fact that ESPP is not fully funded by employees provides no basis to disallow these expenses.” Order at 56. To the contrary, this subsidization exposes ratepayers to significant program expenses arising from the ESPP share price discount and it is only this discount that is proposed for disallowance. AG IB at 26; AG BOE at 8.

The Final Order confusingly concludes that “[t]here is no evidence in the record that any aspect of ESPP is dependent on the achievement of metrics relating to net income or an affiliate’s earnings per share for which recovery under the Section is prohibited.” Order at 56. As described in greater detail in the People’s briefs and in testimony, Mr. Brosch analyzed the ESPP prospectus and determined that the stated purpose of the ESPP “is to provide an added incentive for eligible employees ... to promote Exelon’s best interests.” AG IB at 25; AG BOE at 8. In addition, as discussed further in the Income Tax section related to the ESPP, the People presented evidence that the Company acknowledges that expense impacts arising from this plan are directly related to the “intrinsic value” of Exelon’s stock, compared to the “cash received from the sale of stock to employees under the plan.” See AG Ex. 1.8, ComEd’s response to AG 2.09, part b.

As the People demonstrated, the functioning of the discount plan both increases ComEd's expenses and impacts the delivery service revenue requirement in an amount associated with the fair value of the option on the purchased stock. AG BOE at 9; AG Ex. 3.0 at 29. At the same time, however, the plan provides a financial incentive for participants in the ESPP to maximize earnings and financial performance of ComEd and Exelon, even if this is done at ratepayers expense. The Final Order also pays no attention to the critical point that there is no observable link between Exelon share prices and the quality of delivery services being provided in Illinois. AG IB at 27; AG Ex. 3.0 at 26.

Moreover, the People have shown that the plan is, in fact, governed by Section 16-108.5(c)(4)(A), because it creates expenses for the regulated utility that benefit the parent company that are subject to disallowance. The Final Order misunderstands the impacts that this plan has on ratepayers and, for these reasons, as well as those presented in their briefs, the Commission's decision to reject the People's adjustment on ComEd's Employee Stock Purchase Plan is contrary to law, not supported by substantial evidence, arbitrary and capricious and beyond the jurisdiction of the Commission, contrary to Section 10-201(e)(iv)(A-D) of the Act. In support of this point, the People incorporate by reference the arguments presented at pages 23-31 of the AG Initial Brief; pages 13-16 of the AG Reply Brief; and pages 7-15 of the AG Brief on Exceptions. Accordingly, the People request that the Commission grant rehearing on this matter.

## **B. Income Tax Issue**

As noted in the People's briefs, participating employees will, at some point, dispose of their shares purchased under the ESPP. AG IB at 26; AG RB at 15; AG BOE at 9. When they

do so, these transactions create income tax expense impacts directly tied to the “intrinsic value” of Exelon’s stock. *Id.* It is unreasonable to burden ratepayers with these incremental income tax expenses.<sup>3</sup> To offset this unreasonable outcome, the People recommend disallowing \$1.8 million of income tax expenses associated with the ESPP. AG IB at 29; AG BOE at 10; AG Ex. 1.3, page 3.

The Final Order, however, ignores the very basis upon which the People’s adjustment is rooted. See Order at 56. AG witness Mr. Brosch found an irregular *one-time* charge in ComEd’s bookkeeping at the expense of ratepayers. AG IB at 29-30. The fact that a portion of the asserted test-year cost for ESPP represents a “one-time adjustment” indicates that these prior period adjustments to income taxes are clearly unusual and non-recurring, pre-dating the inception of formula ratemaking for ComEd and should be excluded from cost recovery in formula rates in 2012. AG IB at 29-30; AG Ex. 1.0 at 29. The Final Order, unfortunately, overlooks this argument.

The Final Order continues its misunderstanding of the People’s adjustment where, without support, it concludes that the People “improperly conflate[d] the ESPP-related taxes with tax deductions that Exelon takes regarding dividends paid on shares of Exelon stock held in employee 401(k) accounts.” Order at 56. Quite to the contrary, the People used the Company’s own tax deduction information to support its analysis and to show that ComEd’s treatment of stock-based compensation programs is systematically one-sided to the disadvantage of ratepayers. Specifically, the People demonstrated that Exelon, ComEd’s parent company, takes an annual income tax deduction of about \$13-15 million per year. AG IB at 29; AG BOE at 10;

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<sup>3</sup> See AG Exhibit 1.8 and AG Exhibit 1.0 at 28-29 for specific details regarding the income tax treatment of the ESPP.

AG Ex. 3.0 at 28. However, because the parent submits a consolidated tax filing (Tr. at 246, AG Cross Ex. 6), the related tax savings from this income tax deduction arising from employee ownership of ComEd stock do not get allocated to ComEd or passed on to its ratepayers. Tr. at 90; AG Cross Ex. 3. Therefore, ratepayers are not only burdened with paying for the costs of discounting shares issued under the ESPP and for income tax expenses arising from the ESPP, but they receive no benefit for the large and recurring income tax deductions taken by the parent entity, on the tax return where dividends paid by Exelon on shares held by employees can properly be deducted. AG IB at 29-30.

The Final Order concludes that no adjustment is needed to eliminate these income tax expenses associated with stock-based compensation. Order at 56. This, unfortunately, ignores the valuable income tax deduction benefits realized by Exelon on the consolidated group tax return based upon dividends paid on Exelon common stock held in employee benefit accounts, which have totaled \$15.4 million in 2009, \$15.0 million in 2010 and \$13.6 million in 2011. AG IB at 29; AG BOE at 10-11.

According to the Company's response to data request AG 6.03, part (c), "...only the corporation paying the dividend is entitled to a deduction. As such, none of Exelon's underlying business units may claim or are entitled to share in Exelon Corporation's tax deduction." This means that when employee ownership of Exelon shares creates an income tax benefit, the Company's position is that the resulting tax savings belongs to Exelon alone and need not be shared with ratepayers in Illinois. On the other hand, when the opposite occurs, ComEd proposes that the ESPP income tax costs be treated as fully recoverable from Illinois ratepayers.<sup>4</sup>

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<sup>4</sup> AG Exhibit 3.4 is a copy of the Company's response to data request AG 6.03, which provides more information on this clearly inequitable proposed treatment of the income tax benefits arising from employee ownership of Exelon common stock.

The Commission also concludes that “the ESPP tax expenses related to years prior to 2012 are appropriately included in ComEd’s 2012 rate year because they have not been reflected in prior revenue requirements and ComEd has not accounted for or recovered them.” Order at 56. Whether ComEd has recovered these expenses or not misses the point completely. As the People have previously noted, ESPP expenses, including the associated tax expenses, should be excluded from the determination of the Company’s formula rates. See AG IB at 24-30; AG BOE at 11. The costs of employee benefit plans that reward earnings and financial results and are unrelated to the specific statutory criteria included in section 108.5(c)(4)(A) for permissible incentive compensation expenses should be excluded. AG IB at 29. The income tax expense impacts driven by Exelon stock price valuations should not be included within the determination of formula rates, particularly where such costs arise from one-time adjustments for multiple prior years that arose out of an IRS audit. AG IB at 30; AG BOE at 11. As the People previously noted, recovery of these expenses is inherently unfair to ratepayers, who subsidize the ESPP program but receive no financial benefit when Exelon takes a deduction and achieves tax savings. AG IB at 29-30; AG BOE at 10-11.

Finally, the Final Order adopts Staff’s conclusions on the tax income expenses. Order at 56. In response, the People simply note that while Mr. Brosch performed extensive analysis of the issue, including several reviews of Company-provided information, Staff acknowledged that it performed no discovery and Staff witness Mr. Bridal provided no workpapers or evidence of analysis to the ESPP or its costs. AG Cross Ex. 6; Tr. at 245.

In light of the above and the arguments presented in the People’s briefs, the Commission’s decision to reject the People’s adjustment removing the administrative and general expenses and the unusually large income tax expenses associated with Exelon’s

Employee Stock Purchase Plan is contrary to law, not supported by substantial evidence, arbitrary and capricious and beyond the jurisdiction of the Commission, contrary to Section 10-201(e)(iv)(A-D) of the Act. In support of this point, the People incorporate by reference the arguments presented at pages 23-31 of the AG Initial Brief; pages 13-16 of the AG Reply Brief; and pages 7-15 of the AG Brief on Exceptions. Accordingly, the People request that the Commission grant rehearing on this matter.

#### **IV. The Commission Should Adopt the People's Proposal on Late Payment Charge Allocation**

The Final Order also failed to adopt the People's proposal that Late Payment Charges be 100 percent assigned to the jurisdictional delivery services revenue requirement, ceasing the Allocation to Transmission in the Company's proposed revenue requirement. The People stand by their well-reasoned and supported proposal to credit 100 percent of the Late Payment Charges ("LPC") revenues paid in 2012 by ComEd's delivery service (DS) customers when determining the Company's formula-based Net Revenue Requirement in the event that the Commission adopts ComEd's proposed change to adopt the FERC method of jurisdictional allocation of its G&I Plant. AG Ex. 1.3, page 1; AG IB at 58-62; AG BOE at 15. The People acknowledge that the Company has historically allocated a portion of LPC revenues to the FERC jurisdiction. AG IB at 59. However, the People recommend ceasing the Company's inappropriate allocation of these revenues, directly reducing the formula revenue requirement for 2012 by approximately \$2.526 million. AG IB at 59; AG Ex. 1.0 at 9.

The Final Order concludes, without additional support, that the People's proposal should be rejected because they have "not provided sufficient additional evidence in this proceeding to warrant the deviation from past Commission practice." Order at 69. Contrary to the

Commission's interpretation of the record evidence, the People provided ample evidence in the record to support their proposal. In their Briefs, the People provided a thorough breakdown of the reasoning behind their proposal and walked through the calculation of the proposal. AG IB at 58-61; AG RB at 41-42; AG BOE at 15-16. The People cited to several AG exhibits supporting their proposal, including the testimony of AG witness Mr. Brosch (AG Ex. 1.0 at 9-11); calculations supporting the proposal (AG Ex. 1.3, page 1); and a data request response from the Company describing their position (AG Ex. 1.4). The People also noted that ComEd does not rely upon any FERC order or regulation that requires any allocation of these revenues to the FERC jurisdiction. AG IB at 61; AG BOE at 15-16. In addition, the People observed that the only other Illinois electric utility subject to formula rates does not follow ComEd's proposed allocation of LPC revenues (AG IB at 61, citing to Docket No. 12-0001, Ameren Exhibit 1.3R, page 29).

In short, the substantial evidence in the record demonstrates that the Commission's decision to reject the People's proposal to allocate late payment revenues related to transmission is contrary to law, not supported by substantial evidence, arbitrary and capricious and beyond the jurisdiction of the Commission, contrary to Section 10-201(e)(iv)(A-D) of the Act. In support of this point, the People incorporate by reference the arguments presented at pages 58-63 of the AG Initial Brief; pages 40-43 of the AG Reply Brief; and pages 15-17 of the AG Brief on Exceptions. Accordingly, the People request that the Commission grant rehearing on this matter.



**V. A Recent Fourth District Appellate Court Opinion on Deferred Income Tax Requires the Commission To Revisit and Modify its Final Order on the Issue of Reflecting Net-of-Tax Reconciliation Balances.**

To the extent that the rates authorized in this docket reflect the changes to the formula rate tariff approved by the Commission in Docket No. 13-0553, the People request that the Commission reconsider its rejection of the OAG-proposed adjustment in that docket, which would recognize the tangible financial benefit associated with deferred income taxes and apply interest to the “net-of-tax” reconciliation under-recovery. Reconsideration is particularly relevant in light of a recently issued Fourth District Appellate Court ruling in *Ameren Illinois Company v. Illinois Commerce Comm’n*, Slip Op. 4-12-1008, 4-13-0029 (cons.), dated December 11, 2013 (the “Fourth District Opinion”). That opinion presents new controlling law that specifically authorizes the Commission to interpret the relevant portions of the Public Utilities Act (“PUA”) – including the recent modifications to Section 16-108.5 triggered by Public Act 98-0015 (“PA 98-0015”) -- to deduct deferred tax from the reconciliation balance prior to calculating interest on that balance, consistent with established regulatory principles. As the controlling law of the Fourth District Opinion was not available when the Commission entered its Final Order on November 26, 2013 in Docket No. 13-0553, the Commission should now revisit the issue and adopt the People’s proposed modification to the Company’s formula rate template contained at Appendix C to the People’s Initial Brief.

Second, the Commission’s November 26, 2013 Order in Docket No. 13-0553 imposes an inaccurate interpretation of statutory construction canons to the issue of how the return on equity (“ROE”) “collar” adjustment specified in Section 16-108.5(c)(5) of the Act should be calculated, and imposes the use of end-of-year rate base in making the ROE calculation despite the fact that the recent amendments to the Act that took effect in May of 2013 imposed no such requirement.

The General Assembly's silence on the issue, while taking great pains to insert language that authorized the incorporation of year-end rate base for other components of the formula rate calculation process, point to the need and appropriateness of maintaining the Commission's previous authorization of average rate base on this aspect of the formula rate calculation. To the extent that the Commission's conclusions in Docket No. 13-0553 are reflected in the rates that took effect on January 1, 2014, the People seek rehearing on this issue as well.

#### **A. The December 11, 2013 Fourth District Opinion**

The recent Fourth District Opinion, which was issued approximately one week before the Commission entered its Final Order in this proceeding, stemmed from a consolidated appeal of the Commission's final orders in Ameren Illinois Company's ("AIC") first two electric formula rate cases, Docket Nos. 12-0001 and 12-0293.<sup>5</sup> In that consolidated appeal, AIC challenged, among other issues, the Commission's decision in the two cases to deduct deferred income tax from its filing-year projected plant additions for purposes of calculating rate base. See Docket No. 12-0001, Order of September 19, 2012 at 52-53; Docket No. 12-0293, Order of December 5, 2012 at 29-30. In doing so, the Company argued – just as ComEd and the Commission Staff argued in this case relative to the reconciliation balance – that Section 16-108.5 did not specifically authorize the Commission to deduct accumulated deferred income taxes from AIC's projected plant balances.

The Fourth District appellate court specifically rejected that argument. As the Fourth District Opinion noted, "[w]hile the Commission agrees the [PUA] does not expressly allow an adjustment for [deferred income tax], the Commission explains the statute does not expressly

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<sup>5</sup> A copy of the opinion is attached to this Application for Rehearing as Appendix A.

disallow the adjustment, but authorizes the Commission to exercise its discretion in determining just and reasonable rates.”<sup>6</sup> See Docket No. 12-0293, Order of December 5, 2012 at 29.

Moreover, the Court emphasized that a failure to deduct ADIT from the plant balances at issue would ensure that the Company would gain a significant windfall at the expense of ratepayers. The Court held that deducting deferred income tax from projected plant additions is correct as a matter of prudent accounting: “[o]mitting [deferred income tax] from the rate base calculation would allow Ameren what amounts to an interest-free loan at the ratepayers’ expense that would artificially increase Ameren’s rates until the next reconciliation process, a result which is neither just nor reasonable for ratepayers.”<sup>7</sup>

Additionally, the Fourth District Opinion held that “[a]lthough the [PUA] does not expressly provide for the Commission to reduce the rate base by [deferred income tax], the ratemaking process under the [PUA] is ultimately subject to the Commission’s discretion and authority to determine whether those rates are just and reasonable in accordance with the Commission’s practice and law,” citing § 16-108.5(c)(6) of the PUA.<sup>8</sup> Thus, the Fourth District Opinion held that “[a]s it was consistent with the common practice of the Commission to include [deferred income tax] in the ratemaking process, the Commission did not err by including the [deferred income tax] adjustment for projected plan[t] additions in its ratemaking calculation.”<sup>9</sup>

It is important to note that nothing in Article XVI or Article IX of the PUA expressly authorizes the Commission to deduct deferred income tax from projected plant additions or plant in general for purposes of calculating rate base. Nonetheless, despite the lack of such express

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<sup>6</sup> Fourth District Opinion at ¶ 38.

<sup>7</sup> Fourth District Opinion at ¶ 39.

<sup>8</sup> *Id.*

<sup>9</sup> Fourth District Opinion at ¶ 40.

statutory authorization, the Appellate Court held in the Fourth District Opinion that the Commission has “discretion and authority” to make such deduction, and made particular note of the fact that reflection of ADIT in ratemaking calculations is common regulatory practice of the Commission under Article IX of the Act.

### **B. Implication of the Fourth District Opinion on This Proceeding**

Addressing a slightly different aspect of the annual electric formula ratemaking process, Section 16-108.5(d)(1) of the PUA states that “[a]ny over-collection or under-collection indicated by [the annual] reconciliation shall be reflected as a credit against, or recovered as an additional charge to, respectively, with interest calculated at a rate equal to the utility's weighted average cost of capital approved by the Commission for the prior rate year, the charges for the applicable rate year.” Section 16-108.5(d)(1) says nothing about deducting deferred income tax from the reconciliation over-collection or under-collection for purposes of calculating interest thereon. Although the Commission specifically recognized in its November 26, 2013 Order that it “finds merit in the AG and CCI’s proposal that accumulated deferred income tax, or ADIT should be netted against the reconciliation balance before calculating the interest amount” and that “this concept is consistent with Generally Accepted Accounting Principles, is consistent with standard regulatory practice that matches ADIT elements to the associated assets included in rate base and properly recognizes the cash benefit to the utility that would otherwise have been paid out for income taxes on the amount”, the Commission rejected the proposed ADIT adjustment based on the Act’s failure to specifically permit the deduction. The Commission noted in its November 26, 2013 Final Order that “it is difficult for the Commission to support an interpretation of the Act which

reads into it exceptions, limitations, or conditions the legislature did not express. *Davis v. Toshiba Machine Co.*, 186 Ill.2d 181, 184-185 (1999).” 13-0553 Final Order at 43.

As the Fourth District Opinion stated at ¶ 38, however, the absence of express statutory authorization to deduct deferred income tax from a ratemaking amount in an electric formula rate case does not rob the Commission of its inherent discretion and authority to make such adjustment if necessary to establish just and reasonable rates. The Commission has made clear it finds “merit,” as a matter of prudent accounting, in the People’s proposal to deduct deferred income tax from the reconciliation balance for purposes of calculating interest thereon. 13-0553 Final Order at 43. The new guidance provided by the Fourth District Opinion provides the Commission with assurance that it has the discretion and authority to implement this adjustment, despite the lack of express statutory authorization in Section 16-108.5(d)(1) of the PUA.

Indeed, to not reflect ADIT in the reconciliation under- or over-recovery is necessary to establish rates that are just and reasonable under Article IX of the Act. 220 ILCS 5/9-101. Reflection of ADIT in the reconciliation under- or over-recoveries is necessary to ensure that ComEd’s rates reflect its *actual costs*, as required under Section 16-108.5(c) and (d). 220 ILCS 5/16-108.5(c), 16-108.5(d).

In its Final Order in 13-0553, the Commission stated: “[i]n the future, if further arguments by parties are presented or clarity from the legislature is provided on this topic, the Commission will revisit the issue.” 13-0553 Final Order at 43. The People thus request that the Commission revisit this issue in light of the clear precedent and analysis found in the Fourth District Opinion and the arguments set forth herein, as well as the arguments presented in the People’s Initial Brief, Reply Brief and Brief on Exceptions. Failure to adopt the OAG-proposed deduction of ADIT on the reconciliation over-collection would be contrary to law, not supported

by substantial evidence, arbitrary and capricious, and contrary to Section 10-201(e)(iv)(A-D) of the Act. In support of this request for rehearing, the People incorporate by reference the arguments it presented at pages 31-42 of the AG Initial Brief filed in Docket No. 13-0318; pages 29-48 of the AG Initial Brief filed in Docket No. 13-0553; pages 17-32 of the AG Reply Brief filed in Docket No. 13-0318; pages 52-58 of the AG Initial Brief filed in Docket No. 13-0318; pages 24-37 of the AG Reply Brief filed in Docket No. 13-0553; and pages 13-19 of the AG Brief on Exceptions filed in Docket No. 13-0553. Accordingly, the People request that the Commission grant rehearing on this matter.

**VI. The Commission Should Reconsider Its Rejection Of The Use of An Average Rate Base in the Return on Equity Collar Calculation.**

The Commission's November 26, 2013 Final Order in Docket 13-0553 adopts the Company's and Staff's position to include a year-end rate base in the return on equity ("ROE") collar calculation for annual formula rate updates. In its rejection of the People's proposal to reflect ComEd's average rate base in the ROE collar calculation, the Commission concluded that the General Assembly, when it amended the Act through P.A. 98-0015, intended to use year-end rate base, rather than an average rate base, in the ROE collar calculation because "a year-end rate base is the only rate base specifically prescribed anywhere" in the Act. Docket No. 13-0553 Final Order at 29. This conclusion, however, is based solely on an inference of the General Assembly's legislative intent that is inconsistent with basic canons of statutory interpretation, and should be rejected by the Commission. As discussed below, the plain language and structure of Section 16-108.5 of the Act, the amendments to that section found in P.A. 98-0015, and the Commission's prior decision in Docket No. 12-0321, ComEd's first formula rate reconciliation proceeding, demonstrate that the General Assembly, in fact, neither changed the Commission's

treatment of the ROE collar rate base in Docket 12-0321 nor indicated an intent that year-end rate base be used in the ROE collar calculation.

The Commission's Order notes that the "Act is clear that year-end *capital structure* must be used for purposes of the ROE calculation." Docket No. 13-0553 Final Order at 29 (emphasis added). While this may be true, it is not a basis upon which to adopt a year-end *rate base* for the ROE collar calculation. The Act is silent on the rate base to use in the collar calculation and, contrary to the conclusion of the Final Order – which adopts Staff's and the Company's position on this issue – the Act's silence does not justify the use of year-end rate base for that purpose. Section 16-108.5(c)(5) of the PUA, prior to the passage of P.A. 98-0015, described the ROE collar and directed the Commission to calculate the ROE "using costs and capital structure approved by the Commission as provided in" Section 16-108.5(c)(2). *This section was not amended by P.A. 98-0015.* However, its referent, Section 16-108.5(c)(2), *was* amended by P.A. 98-0015, now providing that the formula rate shall "[r]eflect the utility's actual year-end capital structure for the applicable calendar year." 220 ILCS 5/16-108.5(c)(5). But "capital structure" and "rate base" are not interchangeable terms. Rather, they are independent terms that reflect different calculations.

If the new "year-end capital structure" language found in Section 16-108.5(c)(2), as amended by P.A. 98-0015, is interpreted by itself to require the use of year-end *rate base* in the ROE collar calculation, then that same language alone should, logically, also require the use of year-end rate base in the reconciliation year revenue requirement calculation. However, the General Assembly, in P.A. 98-0015, purposely inserted amendatory language into Section 16-108.5(d)(1) expressly providing that year-end rate base should be used in computing the reconciliation year revenue requirement. If the amendatory "year-end capital structure" language

in Section 16-108.5(c)(2) alone mandates the use of year-end rate base in key formula rate calculations (reconciliation year revenue requirement and ROE collar), then that renders the new “year-end rate base” language in Section 16-108.5(d)(1) as amended by P.A. 98-0015 unnecessary and superfluous.<sup>10</sup> The Commission’s logic on this point in the Final Order is, thus, flawed.

While the General Assembly did not change the ROE collar section of the law (Section 16-108.5(c)(5)) or in any way adopt a requirement to use year-end *rate base* in the ROE collar calculation, a statutory directive addressing how rate base should be calculated for the reconciliation year revenue requirement *was* adopted by the General Assembly. An elementary canon of statutory construction is to avoid interpretations that render any language in the statute superfluous. “A court presumes that the legislature intended that two or more statutes which relate to the same subject are to be read harmoniously so that no provisions are rendered inoperative.” *Knolls Condominium Ass’n v. Harms*, 202 Ill.2d 450, 458-9 (2002). The General Assembly clearly added the amendatory “year-end rate base” language to Section 16-108.5(d)(1) because it wanted to alter the rate base used in the reconciliation year revenue requirement calculation, recognizing that the amendatory “year-end capital structure” in Section 16-108.5(c)(2) did *not* mandate the use of year-end rate base in the reconciliation year revenue requirement calculation. It follows that the “year-end capital structure” amendatory language also did not alter the rate base to be used in the ROE collar calculation. As discussed above,

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<sup>10</sup> Similarly, it is significant to note that Section 16-108.5(c)(5) cross-references Section 16-108.5(c)(2) with regard to the *capital structure* to be used in the ROE collar calculation. However, Section 16-108.5(c)(5) contains no cross-reference to Section 16-108.5(d)(1) with regard to the *rate base* to be used in the ROE collar calculation. P.A. 98-0015 did not address how rate base should be calculated for purposes of the ROE collar. Contrary to the Commission’s conclusion, the General Assembly has not indicated any intention to change the average rate base used in the ROE collar calculation.



capital structure and rate base are two different concepts and the ROE collar calculation measures profitability – not the reconciliation year revenue requirement.

Prior to the passage of the amendatory P.A. 98-0015, the Commission had, in prior formula rate orders, concluded that using an average rate base in the collar calculation accurately reflected the utility's actual cost of investment over the course of the year. *See* Docket No. 11-0721, Order at 18-21 (May 29, 2012) (Commonwealth Edison); Docket No. 12-0001, Order at 174-175 (Sep. 19, 2012) (Ameren). P.A. 98-0015 does not address the Commission's prior adoption of average rate base and did not amend Section 16-108.5(c)(2) to require the use of year-end rate base in the ROE collar calculation. Moreover, neither of the utilities eligible to participate in formula rates challenged the use of average rate base in the ROE collar calculation in prior Commission formula rate dockets in their Applications for Rehearing or on appeal – despite their advocacy for end-of-year rate base in the formula rate reconciliation calculations.

The Commission has, in the past, distinguished between the two issues of (i) average vs. year-end capital structure, and (ii) average vs. year-end rate base. *See, e.g.*, Docket No. 12-0001, Order at 106 (Sep. 19, 2012) (addressing a methodology for determining the Company's capital structure for purposes of the ROE collar calculation, with “capital structure” shown as the percentage mix of common equity, preferred stock, long-term debt, and short term debt). This previously accepted method continues to be presented by the People. As AG witness Effron stated in direct testimony, “the continuing use of the average rate base in the ROE collar calculation is necessary to accurately measure the ROE earned based on the actual equity investment over the course of the year.” AG Ex. 2.0R at 5.

In addition, the Fourth District Opinion expressly found that the failure of the Public Utilities Act to expressly reference a particular ratemaking adjustment did not foreclose the

Commission from making a particular accounting adjustment pursuant to its ratemaking authority. As noted in Part II above, the Court held that “[a]lthough the [PUA] does not expressly provide for the Commission to reduce the rate base by [deferred income tax], the ratemaking process under the [PUA] is ultimately subject to the Commission’s discretion and authority to determine whether those rates are just and reasonable in accordance with the Commission’s practice and law,” citing § 16-108.5(c)(6) of the PUA.<sup>11</sup> In addressing the appropriateness of the OAG’s recommendation to use average rate base in the ROE collar calculation in the pending Ameren Section 9-201 proceeding, the Commission made clear that it believes use of an average rate base in the ROE collar calculation was the correct methodology to produce just and reasonable rates:

The Commission's decisions in Docket Nos. 12-0001 and 12-0293 reflect its belief that use of the average rate base most accurately reflects AIC's costs. The Commission continues to believe that use of the average rate base will produce a dollar balance that correctly represents the actual capital supplied by equity investors to support AIC's rate base over the course of the year for which the ROE is being calculated. Nevertheless, the General Assembly has indicated through PA 98-0015 that it intends for year-end rate base to be used in determining rates. While some ambiguity arguably exists when it comes to the ROE collar calculation, the Commission finds that the overall intent of the General Assembly, as reflected in PA 98-0015, includes the use year-end rate base to calculate the common equity balance for the purpose of determining the earned ROE for the collar calculation.

ICC Docket Nos. 13-0501/13-0517 (cons.), Interim Order of November 26, 2013 at 12.

Accordingly, as the Fourth District Opinion stated at ¶ 38, however, the absence of express statutory authorization for a ratemaking adjustment in an electric formula rate case does not rob

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<sup>11</sup> Fourth District Opinion at ¶39.

the Commission of its inherent discretion and authority to make such adjustment to establish just and reasonable rates.<sup>12</sup>

Failure to adopt the use of average rate base in the ROE collar calculation results, in this case, in excessive rates that do not reflect ComEd's *actual costs*, as required under Section 16-108.5(c) of the Act, and would be contrary to law, not supported by substantial evidence, arbitrary and capricious, and contrary to Section 10-201(e)(iv)(A-D) of the Act. In support of this request for rehearing, the People incorporate by reference the arguments it presented at pages 52-58 of the AG Initial Brief filed in Docket No. 13-0318; pages 23-29 of the AG Initial Brief filed in Docket No. 13-0553; pages 32-40 of the AG Reply Brief filed in Docket No. 13-0318; pages 16-24 of the AG Reply Brief filed in Docket No. 13-0553; and pages 6-13 of the AG Brief on Exceptions filed in Docket No. 13-0553. Accordingly, the People request that the Commission grant rehearing on this matter.

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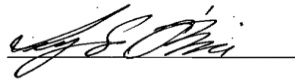
<sup>12</sup> The effect of this treatment of the ROE collar calculation is symmetrical. The People note that in a year where the rate base is declining, which was the case in Docket 12-0321, the use of average rate base will benefit the Company by incorporating a higher rate base into the ROE calculation, compared to using year-end rate base.

## VII. Conclusion

WHEREFORE, the People of the State of Illinois request that the Commission revisit the issue discussed above, grant rehearing and modify its Order of December 18, 2013 in accordance with the arguments presented above.

Respectfully submitted,

PEOPLE OF THE STATE OF ILLINOIS  
By Lisa Madigan, Attorney General

A handwritten signature in black ink, appearing to read 'KLusson', is written over a horizontal line.

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